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BRIEFING BOOK FOR AMBASSADOR DENT

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20 May 1975

MEMORANDUM FOR THE RECORD

SUBJECT: Briefing Book for Ambassador Dent

The attached briefing materials were prepared for Ambassador Dent's trip to Europe. It was delivered to his office on 19 May. The responsible analysts were

25X1A9A

[REDACTED] Contributions were received from I/JP, I/WE, and CRS.

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for
[REDACTED]
Chief
Multilateral Trade Negotiations
Task Force
Office of Economic Research

Attachments:
As stated

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NEW ZEALAND: ECONOMIC POSITION AND POLICIES

New Zealand is seeking greater export opportunities in the United States. Total export earnings actually fell last year, forcing New Zealand to borrow heavily abroad. Output and employment are holding up relatively well because of government pump priming.

THE DOMESTIC SCENE

New Zealand has done better than most OECD countries in maintaining a reasonable level of economic activity. While real growth slowed last year, it still was close to the long-term rate of 3%. Unemployment remains minimal at 0.2% -- only 3,000 persons. This has been accomplished despite a steep decline in foreign demand for New Zealand's agricultural products, the bulk of exports. Inflation has been running at 12%, double the long-term average.

The welfare-oriented economy has been cushioned from the effects of world recession by income redistribution policies. Wellington, which has exceptionally high income tax rates, has pumped aid into the depressed farm sector and increased the public payroll. Various income stabilization funds, financed partly by the government, have lessened the decline in farm incomes. Weakened demand for labor in manufacturing has been met by reducing overtime.

The government will have to continue its hefty income maintenance programs in order to prevent a further slowdown in economic growth. Little help can be expected from foreign customers, who usually purchase 45% of the output of goods. Fixed investment appears to be falling off. Consumer demand should hold up in view of the low rate of unemployment.

DETERIORATING BALANCE OF PAYMENTS

In contrast to the domestic scene, the foreign sector presents serious problems. The current account ran a \$1.1 billion deficit last year, equivalent to 10% of GNP, compared with a surplus of \$200 million in 1973. Imports increased 68% because of greatly increased purchases of US and Japanese manufactures and because of higher oil

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prices. At the same time, demand for exports collapsed. New Zealand was the only OECD member to experience a decline in the value of exports last year, a 6% drop. Volume fell an extraordinary 15% as overseas demand for beef and wool plummeted.

To finance the deficit, Wellington has drawn down exchange reserves by \$340 million, or 30%, and has borrowed heavily abroad. Government and private borrowing reached nearly \$700 million last year, and \$110 million was drawn from the IMF Oil Facility. This year, Wellington expected to increase government borrowing abroad to \$550 million, compared with \$350 million in 1974.

Wellington has tightened its import licensing schedule for the year beginning 1 July to hold down imports. Purchases of autos, textiles, tires, and glassware will be reduced below year earlier levels. The restrictions will reduce licensed imports by about 15% in volume, with a 50% reduction on autos compared to the preceding year.

US-NEW ZEALAND RELATIONS

The US economic presence in New Zealand is negligible. Most foreign investment comes from the United Kingdom and Australia, which also are the major trading partners. Nonetheless, the United States is a large buyer of New Zealand's major exports, taking 70% of the beef and 35% of the dairy products. US sales consist primarily of general machinery and construction and transportation equipment. US exports to New Zealand were \$453 million in 1974, imports \$347 million.

The major issue between the two countries is beef. The US voluntary quota will permit New Zealand to ship at least 5% more beef (by volume) this year than last, but since herds are at an all-time high, New Zealand would like greater relief. Imports this year by Japan and the EC will be too small to be of much help.

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ITALY: OUTLOOK MORE OBSCURE THAN USUAL

Very fragmentary evidence suggests that Italy's recession approached bottom in the early months of the year. Although our best guess is that production will stagnate or decline only marginally in the next few months, we cannot rule out a further steep drop in output.

The sudden and precipitous decline in Italy's industrial production that marked the fourth quarter of 1974 was checked in the first quarter of 1975, when output was down only about 1% despite considerable strike activity as labor fought for improved fringe benefits. Import volume fell much more steeply than domestic output, dropping an estimated 10% in the first quarter. The steep drop in imports probably largely reflected attempts by businessmen to eliminate excess inventories built up in the last half of 1974, as well as the low level of domestic demand.

Declining industrial activity over the past six months has not been reflected in unemployment data. Indeed, January's labor survey showed only 2.7% unemployment. More indicative of the low level of industrial activity was a rapid rise in the number of workers on short-time, up 80% in the first quarter compared with the same period last year.

It is not possible to state with any real confidence just what has been happening to final demand. Indirect evidence, however, indicates that it probably fell only slightly early this year, after a sharp decline in the fourth quarter of 1974. Consumer spending, which accounts for more than half of final demand probably dropped slightly. A small reduction in inflation, improved wage escalator clauses, higher pensions, and better unemployment and short-time benefits probably did not completely offset the adverse effects of higher taxes, increased short-time, and general economic and political uncertainties. Export volume dropped slightly.

Fixed investment -- some 17% of final demand -- suffered the most. Although the repatriation of some capital from abroad eased company financing problems, both housing and plant and equipment spending undoubtedly staggered under the impact of weak demand, rising costs, and continued double digit interest rates.

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Production is likely to stagnate rather than decline steeply in the coming months as the decline in final demand levels off. The sharp drops in output and import volume over the past six months probably have worked off much of Italy's inventory overhang -- never as large as those in the United States and Japan in any case. At the same time, a pick up in production is unlikely through the summer.

A continuous loosening in government policies since February will not have much immediate impact. With capacity utilization among the lowest in Western Europe, freer credit and lower interest rates are unlikely to prod investment. Likewise, increased government spending on unemployment benefits will only help contain any drop in spending. Local and regional elections in June may lead to another government re-shuffle and a slightly more expansionary economic policy after mid-year. Nevertheless, an anticipated worsening in the trade account as inventories are worked off, and the threat of another resurgence of inflation, probably preclude any major injection of new government funds into the economy.

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